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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and other authorities involved	2
Statement	2
Argument	4
Conclusion	9
Appendix	10

CITATIONS

Cases:

Ayer Co. v. *United States*, 38 F. Supp. 284 — 5
Cammarano v. *United States*, 358 U.S. 498 — 7
Commissioner v. *South Texas Co.*, 333 U.S. 496 — 7
Corn Products Co. v. *Commissioner*, 350 U.S. 46 — 7
Fitch Co. v. *United States*, 323 U.S. 582 — 5, 7
United States v. *Leslie Salt Co.*, 350 U.S. 383 — 7

Statute:

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):
Sec. 4161 — 2, 4, 10
Sec. 4216 — 2, 8, 10
Sec. 4216(a) — 2, 4, 5, 10

Miscellaneous:

G.C.M. 21114, 1939–1 Cum. Bull. (Part 1) 351 — 6, 7, 8, 12–18
Rev. Rul. 180, 1953–2 Cum. Bull. 423–424 — 6
Rev. Rul. 206, 1953–2 Cum. Bull. 429–430 — 6
Rev. Rul. 54–61, 1954–1 Cum. Bull. 259–260 — 6

066842—62——1

Miscellaneous—Continued Page
Rev. Rul. 54–448, 1954–2 Cum. Bull. 412 6
Rev. Rul. 60–6, 1960–1 Cum. Bull. 495, 497 7
Treasury Regulations 46:
Sec. 316.8 2, 6, 11
Sec. 316.12 2, 6, 12

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 548

STOWE-WOODWARD, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. 12–21) is reported at 200 F. Supp. 855. The court of appeals' opinion (Pet. 22–28) and its opinion on rehearing (Pet. 29–30) are reported at 306 F. 2d 678.

JURISDICTION

The judgment of the court of appeals was entered on June 28, 1962. A timely petition for rehearing was denied on July 25, 1962. The petition for a writ of certiorari was filed on October 22, 1962. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Whether, in computing the manufacturer's excise tax imposed by Section 4161 of the Internal Revenue Code of 1954, charges collected by a Massachusetts manufacturer of bowling balls to cover the costs of shipping its products to West Coast distribution points in anticipation of future sales may be excluded from the taxable sales price as a "transportation, delivery * * * or other charge" within the meaning of Section 4216(a) of the Code.

STATUTE AND OTHER AUTHORITIES INVOLVED

The relevant portions of Sections 4161 and 4216 of the Internal Revenue Code of 1954, Sections 316.8 and 316.12 of Treasury Regulations 46 (1940 ed.), and G.C.M. 21114 are set forth in the Appendix, *infra*, pp. 10–18.

STATEMENT

The facts, fully stipulated, may be summarized as follows:

The taxpayer manufactures hard rubber bowling balls in Newton Upper Falls, Massachusetts, and sells them in virtually all parts of the United States. (Pet. 12.) All balls shipped from its Massachusetts plant directly to customers are sold at a uniform base price F.O.B. plant, with the freight billed separately or on a "freight collect" basis. (Pet. 13.) Formerly, the cost of shipping balls overland to the West Coast was about $1.50 per ball. However, by shipping the balls—usually by boat, the low-cost means—to public warehouses on the West Coast (Los Angeles and Oakland, California, and Tacoma, Wash-

ington) in shipload (or, occasionally, carload) lots, taxpayer was able to reduce its transportation charges to about $.75 or $.80 per ball, including both shipping and warehouse costs. Although some of the shipments were responsive to specific customer orders, most of them were aimed at maintaining inventories sufficient to meet anticipated future orders. These shipments to public warehouses made it possible for taxpayer to meet price competition on the West Coast and also facilitated speedier delivery to West Coast customers. The warehouses stocked the balls and delivered them to purchasers on notification from the taxpayer, the purchaser making his own arrangements for delivery from the public warehouse to his establishment. The customer was billed the F.O.B. price at the taxpayer's plant (*i.e.*, the price for direct shipments from the plant to customers), and, as a separate item, a flat charge for warehousing and shipping costs of $.75 per ball—of which, $.50 represented shipping costs and the balance warehouse and handling charges. (Pet. 12–14.)

In computing its manufacturer's excise tax liability, the taxpayer applied the 10 per cent rate to all sales on the basis of the F.O.B. plant price, thereby excluding the shipping and warehousing costs incurred on shipments to the West Coast warehouses. (Pet. 14.) The Internal Revenue Service, by including such costs, assessed additional excise taxes for the years 1957 and 1958. Taxpayer paid (Pet. 14–15) these taxes and, after filing claims for refund,

brought this action (more than six months later) for their recovery (Pet. 12, 16).

The district court held that the shipping and warehousing charges were excludable from the sales price subject to tax. (Pet. 12–21.) The court of appeals reversed.[1] (Pet. 22–28.)

ARGUMENT

The decision of the court of appeals is clearly correct. There is no conflict of decisions and no occasion for review by this Court.

1. Section 4161 of the 1954 Internal Revenue Code (Appendix, *infra*, p. 10) imposes a manufacturers' excise tax equivalent to 10 per cent of the price at which certain articles, including bowling balls, are sold. Section 4216(a) (Appendix, *infra*, p. 10) provides that in determining "the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any

[1] Since a minor part of the shipments to West Coast warehouses were made "pursuant to completed sales" to customers (Pet. 13), the government (on brief) in the court of appeals had recognized that the shipping (but not warehousing) costs on these balls would have been excludable, and hence had conceded that—although technically the taxpayer had failed to meet its burden in that respect—the court, in reversing, might remand to the district court with directions to accord the taxpayer an opportunity to establish the actual number of such balls and the shipping charges applicable thereto.

The court of appeals has remanded (Pet. 27), to allow the taxpayer "to establish the number of balls falling in this category"—but apparently on the theory that the entire $3.75 per ball charge was a true shipping charge incurred by the customer, which the government for present purposes does not question.

charge incident to placing the article in condition packed ready for shipment * * *." It further provides, however, that "[a] transportation, delivery * * * or other charge (not required by the foregoing sentence to be included) shall be excluded from the price * * * if the amount thereof is established to the satisfaction of the Secretary * * *."

The court of appeals correctly held that shipping and warehouse charges such as those here in question are not excludable as a transportation or delivery charge under the latter sentence, but are part of the sales "price" under the former. Those charges represented, not the cost of delivery or shipment to the customer, but rather the cost of bringing the balls from the taxpayer's factory to its own distribution centers in anticipation of future orders. The charges were incurred by the taxpayer for its own competitive benefit, *i.e.*, to improve the marketability of its product by establishing inventories in West Coast warehouses, from which expected orders of customers in that area could be filled more speedily and at lower cost to those customers. (Pet. 13.) They contributed to making the balls "ready for shipment" to customers, and were thus plainly includable in the taxable sales price under Section 4216(a). See *Fitch Co.* v. *United States*, 323 U.S. 582, 584–585. See also *Ayer Co.* v. *United States*, 38 F. Supp. 284, 289 (C. Cls.). Only transportation, delivery, installation or similar charges incurred in effecting delivery of an article from the taxpayer's point of distribution or

sale to a customer are excludable from the sales price.[2]

2. The decision of the court of appeals is in accord with longstanding administrative interpretation of the statute. Section 316.8 of Treasury Regulations 46 (1940 ed.) (Appendix, *infra*, pp. 11–12) provides that, in general, the taxable sales price should be "the manufacturer's actual price at the point of distribution or sale," and Section 316.12 (Appendix, *infra*, p. 12) provides for the exclusion of transportation charges only when "actually incurred in connection with the delivery of an article to a purchaser pursuant to a bona fide sale." And G.C.M. 21114, 1939–1 Cum. Bull. (Part 1) 351, declares, with respect to shipments from factory to warehouse (Appendix, *infra*, pp. 15–16):

> A distinction should be drawn in considering the exclusion of freight charges from the selling price between shipments of goods for the sole benefit and convenience of the manufacturer and other shipments constituting the delivery of articles in connection with their sale. Only such charges as are connected with the delivery of articles to a customer pursuant to a sale are to be excluded. Freight charges incurred in moving goods from a factory to a warehouse before a sale is made pertain more closely to expenses attributable to the manufacturer than to deliveries made upon a sale to a customer. Under this rule freight charges

[2] For examples of the application of this rule, see Rev. Rul. 54–448, 1954–2 Cum. Bull. 412; Rev. Rul. 54–61, 1954–1 Cum. Bull. 259–260; Rev. Rul. 206, 1953–2 Cum. Bull. 429–430; Rev. Rul. 180, 1953–2 Cum. Bull. 423–424.

> incurred in shipping products from a factory to a warehouse before a sale is made may not be excluded.

See also Questions 1, 3, 4, and 5 of G.C.M. 2114 (Appendix, *infra*, pp. 14–15, 16–17); Rev. Rul. 60–6, 1960–1 Cum. Bull. 495, 497.

These interpretations are wholly consistent with the language and purpose of the statute, have gone unchallenged for more than 20 years, and have survived frequent reenactment of the statute by Congress. Their validity, as the court of appeals correctly stated (Pet. 25–26, 30), is unquestionable. See *United States* v. *Leslie Salt Co.*, 350 U.S. 383, 396–397; *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 53; see also *Cammarano* v. *United States*, 358 U.S. 498, 508–511; *Commissioner* v. *South Texas Co.*, 333 U.S. 496.

3. The decision below is not, as petitioner asserts, in conflict with this Court's decision in *Fitch Co.* v. *United States, supra*. There, this Court held that certain national advertising costs were includable in the sales price, since they, like the costs at issue here, were incurred prior to shipment to customers. True, the Court did remark that the statute "provides for the use of the manufacturer's or producer's f.o.b. price at the factory or place of production" (323 U.S. at 582, 584). But it had no occasion in *Fitch* to define precisely what it meant by "place of production" or to consider whether that concept might not embrace the taxpayer's distribution center, when the shipment to the customer emanates from there rather than from the factory. Significantly, moreover, this Court, in

concluding that advertising expenses are includable, referred with approval (at p. 586) to the "consistent administrative construction" contained in a portion of G.C.M. 21114 (Question 6, Appendix, *infra*, pp. 17–18) which rests on the same principles as other portions of that G.C.M. which deal with freight charges of the type involved here, and which, as we have indicated *supra*, pp. 6–7, squarely support the position of the government and the decision of the court of appeals in this case.

If the taxpayer here had shipped its bowling balls to California in large bulk cartons and there repackaged them in smaller containers, the costs of such repackaging would, by the express terms of Section 4216, be part of the sales price even though not incurred at the factory. See G.C.M. 21114, Appendix, *infra*, pp. 14–15. By the same token, we submit, costs which the taxpayer incurs in making its product more readily and cheaply available to a large potential market should likewise be deemed a part of the sales price, for here, too, as in the case of packaging and national advertising, the money goes to enhance the commercial attractiveness of the taxpayer's wares.

4. Although, as petitioner asserts (Pet. 10), the decision of the court of appeals is of broad application, it merely reaffirms and clarifies the relevant principles. Since the decision is correct and not in conflict with any other case, further review is not warranted.

CONCLUSION

For the reasons given, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1962.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 4161. IMPOSITION OF TAX.

There is hereby imposed upon the sale by the manufacturer, producer, or importer of the following articles (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof) a tax equivalent to 10 percent of the price for which so sold:

* * * * *

Bowling balls and pins.

* * * * *

SEC. 4216. DEFINITION OF PRICE.

(a) *Containers, Packing and Transportation Charges.*—In determining, for the purposes of this chapter, the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of tax imposed by this chapter, whether or not stated as a separate charge. A transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to the satisfaction of the Secretary or his delegate in accordance with the regulations.

(b) *Constructive Sale Price.*—If an article is—

(1) sold at retail,

(2) sold on consignment, or

(3) sold (otherwise than through an arm's length transaction) at less than the fair market price,

the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary or his delegate.

(c) *Partial Payments.*—In the case of—

(1) a lease,

(2) a contract for the sale of an article wherein it is provided that the price shall be paid by installments and title to the article sold does not pass until a future date notwithstanding partial payment by installments,

(3) a conditional sale, or

(4) a chattel mortgage arrangement wherein it is provided that the sales price shall be paid in installments,

there shall be paid upon each payment with respect to the article that portion of the total tax which is proportionate to the portion of the total amount to be paid represented by such payment.

* * * * * *

Treasury Regulations 46 (1940 edition):

SEC. 316.8 *Basis of tax on sales generally.*—The tax is imposed on the sale by the manufacturer of any of the articles enumerated in these regulations. The provisions of law quoted above embody the rules for determining the sale price, which is the basis of the tax, * * *. In general, this should be the manufacturer's actual price at the point of distribution or sale. In determining the sale price, for tax purposes, there shall be included any charge incident to placing the article in condition packed ready for shipment. There shall be excluded (1) the amount of the tax, whether or not billed as a separate item, and (2) (subject to the provisions of section 316.12) transportation, de-

livery, insurance, installation, or other charges (not required by the preceding sentence to be included).

* * * * *

SEC. 316.12 *Exclusion of charges for transportation, delivery, etc., generally.*—Charges for transportation, delivery, insurance, installation, and other charges actually incurred in connection with the delivery of an article to a purchaser pursuant to a bona fide sale, are to be excluded in computing the tax.

No other additional charge may be excluded in computing the tax unless it can be shown by adequate records to the satisfaction of the Commissioner that such charge properly is not to be included as a manufacturing or selling expense, or is in no way incidental to placing the article in condition packed ready for shipment.

* * * * * *

G.C.M. 21114, 1939–1 Cum. Bull. (Part 1) 351:

TITLE IV.—MANUFACTURERS' EXCISE TAXES.

(1932)

SECTION 619—SALE PRICE.

REGULATIONS 46, ARTICLE 12: Exclusion of charges for transportation, delivery, etc.

1939–17–9806
(Also Article 8.) G.C.M. 21114

Rules governing the inclusion or exclusion of cost of transportation, delivery, insurance, installation, or other charges in determining the prices for which certain articles taxable under Title IV of the Revenue Act of 1932, as amended, are sold by the manufacturer, producer, or importer.

Advice is requested whether, in the situations hereinafter described, transportation, delivery, insurance, installation, or other charges should be included or excluded in fixing the prices for which certain articles subject to tax under Title IV of the Revenue Act of 1932, as amended, are sold by the manufacturer, producer, or importer.

Section 619 of the Revenue Act of 1932 provides in part as follows:

> (a) In determining, for the purposes of this title, the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment * * *. A transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to the satisfaction of the Commissioner, in accordance with the regulations.
>
> (b) If an article is—
>
> (1) sold at retail;
>
> (2) sold on consignment, or
>
> (3) sold (otherwise than through an arm's-length transaction) at less than the fair market price;
>
> the tax under this title shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner.

The taxes under consideration are those imposed under Title IV of the Revenue Act of 1932, as amended, which are based upon the price for which the articles specified are sold by the manufacturer, producer, or importer. Inasmuch as such taxes are

based upon the price for which an article is sold, and since section 619 specifies the charges which shall be included and those which shall be excluded in determining such price, it is evident that there can be no inclusion or exclusion of any charge unless and until a sale is made. In fact, some of the charges specified in section 619—charges for transportation, delivery, and installation—can not be definitely ascertained until the sale is made and the articles are delivered to the purchaser. Many different items enter into the cost of manufactured articles. There are not only manufacturing costs but also items of local taxes, insurance, overhead, cost of handling, and even transportation charges under certain conditions—all attributable to the manufacturer and having no close relation to sales of manufactured articles. Only in respect of *bona fide* sales may the charges specified in section 619 be excluded. The evident purpose of section 619 is to authorize the inclusion in the selling price of certain charges so closely connected with the cost of manufacture or production of taxable articles as to constitute a part of the price for which they are sold, and to exclude from the selling price certain other charges which, though they increase the cost to the customer of securing the articles, yet form no integral part of their selling price.

The questions presented and the answers thereto are as follows:

Question (1): If the articles are shipped in case lots from the factory to the warehouse and are shipped in less than case lots from the warehouse to the customer, are the articles in condition "packed ready for shipment," within the meaning of section 619, at the time they leave the factory or not until they are packed in the smaller quantity to fill the customer's order?

Answer: Inasmuch as the tax becomes due upon the sale of a taxable article and is measured by the selling price thereof, the provisions of section 619 prescribing the basis for determining such price in respect of the charges specified therein must be considered as having some relation to, or being connected with, the sale of the article. Taxable articles are frequently shipped by a manufacturer from a factory to a warehouse in bulk or in larger quantities than are normally sold to customers. These shipments are made solely for the benefit or convenience of the manufacturer before the sale is made. It is the opinion of this office that the term "packed ready for shipment," embodied in section 619, means the condition which exists when an article taxable under the law is inclosed in a covering or container ready for delivery to a customer upon a *bona fide* sale thereof made by the manufacturer, producer, or importer.

Question (2): A manufacturer makes no sales from the factory, all deliveries being made from branch warehouses in various cities, the price to the customer being the same at all the warehouses. May he exclude the freight charges incurred in shipping his products to the branch warehouse?

Answer: A distinction should be drawn in considering the exclusion of freight charges from the selling price between shipments of goods for the sole benefit and convenience of the manufacturer and other shipments constituting the delivery of articles in connection with their sale. Only such charges as are connected with the delivery of articles to a customer pursuant to a sale are to be excluded. Freight charges incurred in moving goods from a factory to a warehouse before a sale is made pertain more closely to expenses attributable to the manufacturer than to deliveries made upon a sale to a customer. Under

this rule freight charges incurred in shipping products from a factory to a warehouse before a sale is made may not be excluded.

Question (3): A manufacturer has warehouses in various cities. Having a surplus stock in one warehouse, he reships to another warehouse to increase a depleted stock. May the freight charges so incurred be excluded?

Answer: For the reasons indicated in the answer to question (2), freight charges incurred by a manufacturer in reshipping goods from one of his warehouses to another before a sale of the articles is made may not be excluded.

Question (4): A manufacturer has a local warehouse in the city where the factory is located, the warehouse being some distance from the factory. May the expense of delivery to the warehouse be excluded (*a*) if an outside transfer company is employed, and (*b*) if the manufacturer maintains his own trucks for this specific purpose?

Answer: It seems immaterial to this office, in considering the exclusion of an expense incurred for transportation or delivery, whether such expense represents a specific charge made by a transfer company or whether the expense arises from the use of trucks maintained by the manufacturer in accomplishing the same purpose. In either event, if the delivery is made in completion of a sale to a customer, the item represents the cost or charge for transportation or delivery such as are to be excluded from the selling price under the law. If, however, the delivery is solely for the benefit or convenience of the manufacturer, such cost may not be excluded.

Question (5): A manufacturer receives an order from a customer in another city. His warehouse near the customer has not enough goods on hand to fill the

order. Part of the goods ordered is shipped from the factory and part from the warehouse. What freight or transportation charges may be excluded?

Answer: Bearing in mind the test of exclusion is whether or not the shipping cost is incurred in connection with the movement of goods in completion of a *bona fide* sale to a customer, it follows that the freight or transportation charges to be excluded in the example given are only those which are actually incurred in the shipment of the goods to the customer, irrespective of whether the shipment is made from the factory, from the warehouse, or in part from both.

Question (6): If the transportation cost from factory to warehouse is to be excluded, does the statute contemplate the exclusion of other costs incurred after the goods are packed ready for shipment, namely, insurance at the warehouse, handling and other expenses at the warehouse, etc.?

Answer: The items of "transportation, delivery, insurance, installation, or other charge" are evidently used in section 619 as belonging to the same general class of deductions. Under the rule of construction of statutes *noscitur ex sociis,* all the items must therefore be treated alike. Certainly the items of transportation, delivery, and installation have relation to events occurring after the goods leave the factory or the warehouse. A manufacturer may protect himself from loss at factory or warehouse by insurance and inevitably incurs expense for handling goods at both places. But, as viewed by this office, those items may be excluded only when connected with a sale and may not be excluded when incurred by the manufacturer for his own use or benefit before a sale is made. For example, the cost of insuring goods at the factory or warehouse is attributable to the manufacturer and should be reflected in the selling price. The cost of

insuring goods after a sale is made and while en route to a customer forms no part of the selling price and may properly be excluded in determining the amount of tax due.

Question (7): Where the Commissioner, for the purpose of computing tax, determines the fair market price of a taxpayer's product under the authority granted him by section 619(b) of the Revenue Act of 1932, may any exclusion be allowed from such fair market price for transportation charges or any other of the items enumerated in section 619(a)?

Answer: There is a close relation between the terms of section 619 (a) and (b) of the law. Under (a) the Commissioner is authorized to determine the selling price by including or excluding certain specified items. Under (b) the Commissioner is authorized to determine the fair market price in transactions where the prices at which articles are sold are below the normal selling prices.

In making a determination of fair market price under section 619(b), the Commissioner must necessarily take into consideration all elements, including the same items which would be included or excluded under authority of section 619(a), but once the fair market price under (b) is finally determined, the tax must be based on that price and the statute does not contemplate any further adjustments.

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